

Message Text

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TO SECSTATE WASHDC IMMEDIATE 8351

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 19421

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TAGS: EFIN, UK

SITUATION REPORT, DECEMBER 2

REF: (A) STATE 267168; (B) LONDON 19355

1. AN EXERCISE IN WHITEHALLOLOGY. NO WORD YET FROM THE CABINET, WHICH MET YESTERDAY AND WILL MEET AGAIN TODAY TO CONSIDER ECONOMIC MEASURES TO BE TAKEN IN CONNECTION WITH THE IMF LOAN. HOWEVER, A PRESS SOURCE, WHO HAS TALKED WITH HEALEY, TELLS US THAT THE CHANCELLOR WILL BE PROPOSING A PACKAGE CONSISTING ENTIRELY OF EXPENDITURE CUTS. THESE WOULD AMOUNT TO \$2 BILLION, \$1.5 BILLION TO TAKE PLACE "IMMEDIATELY" (PRESUMABLY AS OF THE APRIL 1 BEGINNING OF A NEW FISCAL YEAR) AND \$500 MILLION IN A SECOND PHASE.

WE ALSO UNDERSTAND THAT HAROLD LEVER FEELS HE HAS FOURTEEN OF THE 24-MEMBER CABINET IN HIS ANTI-DEFLATION" CAMP. ON THE BASIS OF SEEMINGLY WELL FOUNDED PRESS REPORTS (AND IN A FEW CASES STATEMENTS OF THE MINISTERS CONCERNED) IT SEEMS PROBABLE THAT THE FOLLOWING TWELVE MINISTERS ARE IN THE LEVER GROUP: LEVER, CROSLAND, FOOT, SHORE, ENNALS, HATTERSLEY, WILLIAMS, RODGERS, ORME, BENN, SILKIN. BOOTH. WE THINK IT PROBABLE THAT

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THE MINISTER OF DEFENSE, FRED MULLEY, WOULD, LIKE OTHER

HEADS OF LARGE-SPENDING DEPARTMENTS (E.G., SHORE, WILLIAMS, ENNALS), BE OPPOSED TO MEASURES INVOLVING LARGE EXPENDITURE CUTS: HE MAY THEREFORE BE A THIRTEENTH LEVERITE. ON THE OTHER SIDE HEALEY, DELL, AND PRENTICE ARE UNIVERSALLY REGARDED AS PRO-CUTS. LEVER EXPECTS VARLEY AND REES WILL ALSO END UP ON THAT SIDE. VARLEY IS REPORTED IN THE TIMES TO HAVE SPOKEN IN FAVOR OF HEALEY'S LINE IN AN EARLIER CABINET COMMITTEE DISCUSSION. WE HAVE NO DEFINITE FEELING ABOUT REES. THE REMAINING SIX CABINET MEMBERS - CALLAGHAN, ELWYN-JONES, MASON, MILLAN, MORRIS, AND PEART - ARE IN NO CASE LEFT WINGERS - BUT THE DIVISION ON THIS ISSUE HAS NOT BEEN BETWEEN LEFT AND RIGHT, BUT RATHER HAS SPLIT THE RIGHT WING. PERHAPS MORE SIGNIFICANT IS THAT NONE OF THEM HEADS A MAJOR SPENDING DEPARTMENT.

THE DAILY TELEGRAPH REPORTS "BITTER DISSENT IN THE CABINET" WITH THE CHANCELLOR'S CREDIBILITY BEING UNDERMINED AS A RESULT OF HIS FAILURE TO GET AGREEMENT ON THE SIZE OF PROPOSED CUTS IN PUBLIC SPENDING. THE TELEGRAPH SAYS THE CABINET DISPUTE, DESCRIBED AS DEEP AND WIDE, CENTERS AROUND OPPOSITION TO CUTS OF 1 TO 1.5 BILLION POUNDS IN FY 77 PUBLIC EXPENDITURE. THE TELEGRAPH ASSERTS: "THERE IS NO DOUBT BRITAIN WILL GET THE LOAN, AS AMERICAN AND WEST GERMANY HAVE VIRTUALLY GUARANTEED THIS TO MR. CALLAGHAN".

2. THE FINANCIAL TIMES REPORTS, IN A DAVID BELL ITEM FROM WASHINGTON, THAT THE IMF IS BELIEVED TO HAVE PROPOSED A MONEY SUPPLY TARGET OF 10 PERCENT OVER THE NEXT TWO FISCAL YEARS. THIS WOULD BE ACCOMPANIED BY STRINGENT PERFORMANCE CLAUSES ALLOWING DISBURSEMENT OF THE \$3.9 BILLION ONLY IF INTERIM TARGETS WERE ACHIEVED. BELL ALSO REPORTS ANXIETY AT THE IMF OVER DISSENTION IN THE CABINET WHICH IT IS BELIEVED STEMMED FROM THE WAY IN WHICH THE DISCUSSIONS IN LONDON WERE HANDLED. THE FACT THAT THE TALKS BEGAN BELOW THE POLITICAL LEVEL AND WERE ALLOWED TO BECOME PROTRACTED IS BELIEVED TO HAVE ALLOWED DOMESTIC OPPOSITION TO DEVELOP THUS PLACING

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THE IMF IN AN EXPOSED POSITION. THE IMF IS REPORTED TO BELIEVE THAT ALL NOW DEPENDS ON HOW H.M. GOVERNMENT SELLS THE AGREEMENT. IN THE VIEW OF SENIOR FUND OFFICIALS, REFERENCES TO A PARTICULAR PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) WOULD NOT HAVE TO BE INCLUDED IN A LETTER OF INTENT IF H.M. GOVERNMENT MAKES SOME REFERENCE TO A TARGET OF ABOUT 8 BILLION POUNDS IN THE FISCAL YEAR 1977-78 IF AND WHEN THE PACKAGE IS

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ANNOUNCED. ON STERLING BALANCES, SOME G-10 MEMBERS ARE SAID TO FAVOR A QUICK DECLARATION OF SUPPORT FOR TALKS WHEN THE ECONOMIC PACKAGE IS ANNOUNCED.

3. IN A RELATED DEVELOPMENT, CALLAGHAN DENIED THAT H.M. GOVERNMENT WAS SEEKING FURTHER HUGE LOANS FROM THE EC. THIS DENIAL CAME IN REPLY TO A COMMONS QUESTION FROM THE LEADER OF THE OPPOSITION. THE PRIME MINISTER SAID "FURTHER LARGE LOANS FROM THE COMMUNITY WERE NEITHER ASKED FOR NOR OFFERED AND THERE IS NO QUESTION OF THE COMMUNITY, CERTAINLY NOT IN YESTERDAY'S DISCUSSIONS, BEING INVOLVED IN ANY DIRECT SENSE."

4. LAST EVENING'S DISCUSSION BETWEEN THE TUC LEADERS AND PRIME MINISTER AND OTHER MINISTERS HEWED CLOSE TO THE SCENARIO SUGGESTED BY DAVID BASNETT (REF B). LEN MURRAY SPOKE TO THE PRESS AFTER THE TWO-HOUR MEETING AND HE REPORTED THAT THE GOVERNMENT "HAD BEEN VERY GUARDED INDEED" ABOUT ITS TALKS WITH THE IMF AND THAT THE TUC WAS GIVEN NO INDICATION OF THE SHAPE OR SCOPE OF THE GOVERNMENT'S FORTHCOMING AUSTERITY PACKAGE. HE INDICATED THAT THE TUC TOLD THE PRIME MINISTER THAT IT WAS ESSENTIAL FOR THE GOVERNMENT TO HEW TO ITS PRESENT INDUSTRIAL STRATEGY AND NOT TO ENGAGE IN MAS-

SIVE EXPENDITURE CUTS, WHICH WOULD BE COUNTERPRODUCTIVE
IN THE FIGHT AGAINST INFLATION AND WOULD ENDANGER THE
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SOCIAL CONTRACT, AS WELL AS THE POSSIBILITY OF FURTHER
WAGE RESTRAINT. HOWEVER, THE TUC LEADERS ASSURED THE
MINISTERS IT WOULD STICK WITH THE PRESENT WAGE RE-
STRAINT POLICY, WHICH ENDS JULY 30, 1977. THE PRESS
HIGHLIGHTED THE INDICATION BY MURRAY THAT THE TUC MIGHT
ACCEPT A FURTHER PERIOD OF WAGE RESTRAINT WHEN THE
CURRENT LIMITS EXPIRE WITH THE FINANCIAL TIMES (DECEMBER
2) CALLING IT THE TUC'S "FIRST PUBLIC HINT". IN FACT,
THE TUC IMPLIED THAT IT WOULD CONSIDER A FURTHER
PERIOD OF SUCH RESTRAINT BACK AT ITS SEPTEMBER CONGRESS.

5. FOREIGN EXCHANGE AND FINANCE. THE POUND REGISTERED
A SUBSTANTIAL GAIN OF 1.05 CENTS ON WEDNESDAY, CLOSING
AT \$1.6630, A RISE OF 1.05 CENTS ON THE DAY. MARKET
SOURCES HESITANTLY PLACED THE CAUSE FOR THE
INCREASE IN MANY PLACES. SOME SUGGESTED THAT THE
MARKET RESPONDED POSITIVELY TO THE CHANCELLOR'S SPEECH
INDICATING THAT THE UK WILL GET THE IMF LOAN ON TERMS
WHICH ARE NOT TOO HARD, OTHERS THAT THE MARKET WAS
HAPPY WITH THE PROSPECT OF A PUBLIC SECTOR BORROWING
REQUIREMENT IN THE LOWER RANGE OF PRIOR FORECASTS, WHILE
THE FINANCIAL TIMES (FT) SUGGESTED THAT ITS WEDNESDAY
STORY THAT THE U.S. WAS SOFTENING ITS RELUCTANCE TO
HELP FUND STERLING BALANCES WAS A SOURCE OF SOME
STRENGTH.

THE GILT MARKET SHOWED SOME EARLY STRENGTH ON
WEDNESDAY, IN SYMPATHY WITH THE STERLING MOVEMENT, BUT
TRADING BECAME EXTREMELY LIGHT AS THE DAY PROGRESSED.
GILT PRICES ENDED THE DAY WITH GAINS IN MOST MATURITIES
OF LESS THAN 1/4.

THERE WAS VERY LITTLE ACTIVITY IN THE EQUITY MARKET
AS THE FT INDEX OF 30 INDUSTRIAL STOCKS INCREASED FROM
297.6 TO 301.3.

THE BANK OF ENGLAND LENT LARGE SUMS TO EIGHT DIS-
COUNT HOUSES ON WEDNESDAY, A SMALL AMOUNT BEING LENT
FOR EIGHT DAYS AT THE CURRENT MINIMUM LENDING RATE
(MLR). THIS IS TAKEN AS A SIGNAL TO THE MARKET THAT
THE BANK OF ENGLAND DOES NOT WELCOME A FURTHER REDUCTION
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IN THE MLR THIS WEEK.

ARMSTRONG

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